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Decision 02-11-028 November 7, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company for Authority Pursuant to Public Utilities Code Section 851 to Sell Cushion Gas in its Aliso Canyon and La Goleta Storage Fields. (U 904 G)	Application 01-04-007 (Filed April 9, 2001)

(See Appendix A for List of Appearances.)

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OPINION REGARDING THE SALE OF THE RECLASSIFIED CUSHION GAS

I. Summary

Previously, in Decision (D.) 01-06-086, the Commission authorized Southern California Gas Company (SoCalGas) to perform the well drilling and associated work that would allow SoCalGas to free up and reclassify 14 billion cubic feet (Bcf) of cushion gas as working gas available for sale at its gas storage fields located at Aliso Canyon and La Goleta. D.01-06-086 prohibits SoCalGas from selling the reclassified cushion gas until the Commission directs SoCalGas to do so on the terms and conditions specified in a future Commission decision.

In this decision, we consider what should be done with the 14 Bcf of gas, how the proceeds from the sale of the gas should be allocated, and how the additional storage inventory capacity (storage capacity) should be classified.

Today's decision adopts the alternative proposal of the Office of Ratepayer Advocates (ORA). This proposal would transfer 5.88 Bcf of the 14 Bcf of reclassified gas to the core at book value. The remaining 8.12 Bcf of gas would be allocated to noncore customers in the amount of 2.52 Bcf, and 5.6 Bcf to SoCalGas. The 8.12 Bcf would then be sold on the open market using a sealed bid procedure. The proceeds would then be used to reimburse SoCalGas for the book cost of 8.12 Bcf of gas, and project costs in the amount of $23 million. SoCalGas is authorized to carry out ORA's 60/40 proposal. The decision also adopts SoCalGas' recommendation to classify the additional 11 to 14 Bcf of storage capacity created by the project to be part of the noncore unbundled storage program.

II. Background

SoCalGas filed its application with the Commission on April 9, 2001. The application described how SoCalGas planned to make design changes at its Aliso Canyon and La Goleta underground gas storage fields through a combination of drilling new wells and reworking existing wells. According to the application, the redesign work would allow SoCalGas to provide the same level of deliverability with less cushion gas at both fields. This would make available 14 Bcf of cushion gas, which could then be reclassified as working gas and sold on the open market. In addition, the rework project would create additional storage capacity of up to 14 Bcf.

D.01-06-086 authorized SoCalGas to perform the redesign work, and to reclassify 7 Bcf of cushion gas at Aliso Canyon and 7 Bcf of cushion gas at La Goleta as working gas available for sale. The decision also authorized SoCalGas to sell the reclassified gas "on the terms and conditions specified in a future Commission decision." (D.01-06-086, p. 37.) The decision also stated that there would be a second phase of this proceeding to address all of the remaining ratemaking issues, "including the allocation of the anticipated net gain on sale of the reclassified cushion gas, the anticipated reduction in prospective operating costs, and the allocation of benefits among customer classes…." (D.01-06-086, p. 32.)

Ordering paragraph 2 of D.01-06-086 solicited comments on whether any restrictions should be imposed on SoCalGas with respect to the sale of the 14 Bcf of gas, and the advantages or disadvantages of the various proposals to restrict the sale of the reclassified cushion gas.

Following the filing of comments, a draft decision regarding what should be done with the 14 Bcf of gas was placed on the Commission's December 6, 2001 agenda for consideration. An alternate to the draft decision was also prepared. At the Commission meeting of March 6, 2002, both the draft decision and the alternate were withdrawn from the agenda. After the withdrawal of the two agenda items, an assigned Commissioner's ruling was issued on April 11, 2002 stating that the "sense of urgency in selling the 14 Bcf of gas has now passed," and that "Given the passage of time, and the lack of an urgent need to specify the terms and conditions of the sale of the gas, there is a window of opportunity to consider the terms and conditions of the sale together with the ratemaking issues that are currently scheduled for Phase 2." The ruling sought comments from the parties on how the Commission should proceed. Opening and reply comments were filed in response to the ruling.

On June 7, 2002, a second assigned Commissioner's ruling was issued which set a schedule for addressing both the sale of the reclassified gas and the Phase 2 issues, as well as issues about the carrying costs associated with the delay in issuing a decision authorizing the sale of the gas, the total cost of the project, and the water intrusion / storage capacity issues. An evidentiary hearing was held on July 29, 2002, and the matter was submitted with the filing of reply briefs on August 29, 2002. Oral argument was held on November 4, 2002.

III. Position of the Parties

A. SoCalGas

SoCalGas recommends that it be allowed to sell all of the reclassified cushion gas to the highest bidder under the terms and conditions proposed by it in this proceeding, and that the book value of the cushion gas, the cost of the well work, and taxes, be deducted from the sale proceeds. SoCalGas proposes that the net gain from the sale of the gas be allocated equally to ratepayers and shareholders.[1] If the sale produces a net loss after the project costs, the book cost of the reclassified gas, and taxes are paid, SoCalGas proposes that the loss be allocated to shareholders only. SoCalGas also recommends that the Commission assign the additional 11 to 14 Bcf of additional storage capacity to the noncore unbundled storage program.

SoCalGas asserts that the Commission should reward SoCalGas' shareholders for initiating this project because it brought an additional 14 Bcf of natural gas to the California gas market during the winter of 2001-2002 when there was a possibility of abnormally high system capacity utilization and high gas commodity prices at the California border.[2] The availability of this gas benefited both core and noncore customers because it provided insurance against the curtailment of SoCalGas' noncore customers, including electric generation customers who produce electricity.

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[1] If SoCalGas' proposal is adopted, SoCalGas would credit recorded storage costs with an amount equal to the book value of the cushion gas. The $23 million in project costs would be accounted for as an offset to the cushion gas sale proceeds. SoCalGas would credit rates with the ratepayers' share of the net gain in the first January 1 rate adjustment following Commission approval and completion of the sale.

[2] SoCalGas contends that the costs incurred in completing this project, approximately $23 million including an Allowance for Funds Used During Construction (AFUDC) of $1.5 million, cannot be considered as a reward or incentive for SoCalGas' shareholders for undertaking this project because utilities are entitled to recover the prudently incurred costs of facilities used to provide public utility service. SoCalGas states that the recovery of this amount simply reaffirms the Commission's promise in D.01-06-086 that SoCalGas would be entitled to recover the costs associated with the project, and that none of the parties have opposed the recovery of the project costs.

SoCalGas states that there are only two sources of shareholder reward available in this proceeding. One is to allocate to shareholders a portion of the gain on sale of the reclassified cushion gas. The other source of reward for shareholders is the revenue that might be produced by the sale of the additional storage inventory capacity after the reclassified gas is sold.

SoCalGas contends that when a project provides significant benefits to ratepayers, the Commission has allocated a portion of the gain on sale to shareholders. In addition to ratepayers benefiting from the availability of an additional 14 Bcf of gas supply, SoCalGas proposed the project because it was anticipated that the sale of the reclassified gas would generate a large gain on sale that could benefit both ratepayers and shareholders. With the subsequent drop in gas prices, SoCalGas estimates that if it sells the 14 Bcf of gas at $3.80 per Mcf, this will yield a net after-tax gain of $15.2 million. Since ratepayers have benefited from this project, SoCalGas recommends that the Commission reward SoCalGas' shareholders by allocating the gain on sale of the reclassified gas equally between ratepayers and shareholders.

The project will also result in an additional 11 to 14 Bcf of storage capacity immediately after the cushion gas is sold.[3] SoCalGas estimates that the value of an additional 11 to 14 Bcf of storage capacity will range from $2.4 to $3.0 million per year, based on current tariff rates.[4] SoCalGas states that the value of this

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[3] Due to water intrusion, SoCalGas may not be able to sell all 14 Bcf of additional storage. According to SoCalGas' witness, this will not be known until SoCalGas has operated the reconfigured fields for several years.

[4] SoCalGas contends that the proposals of TURN, ORA and SCGC incorrectly assume that there will be significant additional revenues from the sale of the storage capacity.

expanded storage capacity is difficult to determine at this time because it does not know the extent to which noncore customers will choose to purchase this additional capacity.[5] SoCalGas points out that the construction of additional interstate pipeline capacity to California, combined with SoCalGas' expansion of its backbone transmission system, might cause some noncore customers to forego purchasing SoCalGas' storage products, including the additional storage capacity. Following the interstate pipeline expansions in the early 1990s, SoCalGas could not sell all of the available unbundled storage capacity at tariff prices for several years. SoCalGas contends that this is likely to happen again following the doubling of capacity of the Kern River pipeline over the next year.

SoCalGas also points out that since the project did not increase SoCalGas' firm injection or withdrawal capacity,[6] that it will only receive incremental firm injection or withdrawal revenues to the extent the additional storage capacity allows SoCalGas to sell more injection / withdrawal rights than it would in the absence of the additional storage capacity. SoCalGas asserts that there is no reason to believe that the additional storage capacity will produce incremental firm injection or withdrawal revenues during the storage cycle off-season.

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[5] SoCalGas argues that it did not undertake this project solely for the purpose of creating additional unbundled storage capacity. Thus, the arguments of TURN and ORA that prior Commission decisions have placed SoCalGas' shareholders at risk for the cost associated with creating additional unbundled storage capacity are irrelevant because SoCalGas did not undertake the project for that purpose.

[6] SoCalGas points out that the 7% increase in average maximum injection rate that SoCalGas witness Mansdorfer referenced is based on injection of the same volume in the past, but with a 7 Bcf lower inventory. SoCalGas contends that this additional average injection rate cannot be sold as firm injection capacity because SoCalGas cannot rely on its availability, which depends on how customers manage their inventory.

Even if some additional storage inventory/injection/withdrawal revenues are obtained as a result of the additional storage capacity, SoCalGas contends that there is uncertainty about the extent to which these revenues would be shared with ratepayers. Under the present structure, the balance in the noncore storage balancing account is shared equally between shareholders and ratepayers, with the ratepayer share allocated on an equal cents-per-therm basis.[7] The Comprehensive Settlement Agreement (CSA) adopted in the Gas Industry Restructuring (GIR) decision includes a schedule for ratepayer and shareholder sharing of the difference between unbundled storage costs and the revenues from unbundled storage service. However, that schedule has been challenged as part of the process of implementing the CSA. SoCalGas states that the mere possibility of additional revenues from the additional storage capacity should not be viewed as a sufficient benefit to SoCalGas' shareholders.

SoCalGas states that another benefit to ratepayers are the reduced operating costs at the two storage fields and a reduction to rate base. The reduced operating costs include fuel savings estimated to be about $280,000 annually, and reduced emission credits of approximately $19,000 per year.

SoCalGas contends that the only "meaningful reward" for its shareholders is an equal sharing of the gain on sale of the reclassified gas. If the gas can be sold at $3.80 per Mcf, a net, after tax gain of $15.2 million would be generated. Sharing this gain equally between shareholders and ratepayers would give

[7] SoCalGas contends that under TURN's forecast of additional revenues, core customers would receive a benefit of $1.5 million per year so long as the excess storage revenues are shared equally between ratepayers and shareholders. Thus, SoCalGas contends that any reference to the possibility of future benefits from any revenues produced by the additional storage capacity should recognize this benefit to the core.

shareholders an after tax gain of $7.6 million. Accordingly, SoCalGas recommends that the Commission authorize SoCalGas to sell all of the reclassified gas on the open market, and that the gain on sale be shared equally between ratepayers and shareholders.

SoCalGas contends that the additional storage capacity created by the project should be assigned to the noncore unbundled storage program because the core does not need this additional capacity. The core storage inventory target identified in the GIR decision, D.01-12-018, and in the Gas Cost Incentive Mechanism decision, D.02-06-023, was 70 Bcf, plus or minus 5 Bcf, as of November 1st of each year. This allocation of core storage capacity is 15 Bcf higher than the inventory allocation contemplated in the CSA. If the additional 11 to 14 Bcf of storage capacity is assigned to the noncore, the core will still be able to maintain its 70 Bcf of storage inventory. (See D.01-12-018 at p. 58, fn. 32.) SoCalGas asserts that the Commission should make clear in this decision that this additional capacity is to be allocated to the noncore unbundled storage program, and that any revenues from the sale of this additional storage capacity should be treated like other revenues generated by the unbundled noncore storage program.

SoCalGas states that the well rework project cost more than what was estimated in the application due to the following factors: higher mobilization and day rate for drilling rigs; higher costs for other drilling-related services; higher costs for the rework activities; unexpected site preparation costs; and higher surface piping and valve costs. SoCalGas states that it notified the Commission of the higher expected costs in the monthly reports that were provided to the Commission as soon as SoCalGas became aware of the increased costs. Also, the application referred to the estimated costs as approximations of SoCalGas' best estimates, and D.01-06-086 recognized that the $16 million was only an estimate of the project costs. SoCalGas contends that it did everything possible to control and minimize the cost of the project, and that no party presented any evidence to the contrary.

SoCalGas states that SCGC's proposal that a longer withdrawal period be allowed should not be adopted. By limiting the withdrawal period to the November 2002 – March 2003 time frame will ensure that once the gas is sold, that the 11 to 14 Bcf of capacity can be refilled during the summer 2003 injection period in time for winter 2003-2004. SCGC's proposal could leave this inventory space empty as of October 31, 2003, which would limit the ability of noncore customers to utilize this additional storage capacity during the 2003-2004 winter season. Since California border gas prices tend to be highest during the winter period, SoCalGas asserts that requiring the gas to be withdrawn by March 1, 2003 will tend to maximize the sales price of the reclassified gas.

SoCalGas also states that SCGC's concern that the 14 Bcf of gas might not be able to be withdrawn from storage because of the winter balancing rules is misplaced. SoCalGas asserts that successful bidders will be able to withdraw all of their gas with as-available withdrawal rights, as well as firm withdrawal rights.

SoCalGas disagrees with SCGC's proposal that if the CSA is implemented, that the Commission should require SoCalGas to adjust its tariff and ceiling rates for its unbundled noncore storage products to reflect the reduced level of rate base and operating cost. SoCalGas contends that this is unnecessary and inappropriate because under the CSA, there is a mechanism that allows any storage cost savings and increases to be shared between ratepayers and shareholders.

SoCalGas agrees with SCGC that customers who already own storage inventory capacity should be permitted to transfer some or all of the reclassified cushion gas into their inventory accounts, space permitting, instead of being required to withdraw the gas during the specified withdrawal period.

SoCalGas contends that the two proposals of ORA are unnecessarily complicated, and do not address the means by which SoCalGas would recover its project costs as promised in D.01-06-086. In addition, ORA's proposals allocate too little of the project benefits to SoCalGas' shareholders. If the Commission decides to adopt either of ORA's proposals, SoCalGas states that the Commission should assign a proportionate share of the project costs, along with the gas, to the core.[8] If this assignment does not occur, SoCalGas contends it might not recover its project costs.

SoCalGas states that the proposal of The Utility Reform Network (TURN) to transfer all of the reclassified gas to the core at book value plus the project costs was not sponsored by any witness, and has not been sufficiently developed for meaningful consideration. Under TURN's proposal, SoCalGas asserts that its shareholders would receive no meaningful benefits, and noncore customers would receive no benefits. TURN's proposal also overlooks the benefits that the project brought to core customers, as described earlier.

SoCalGas opposes TURN's recommendation that core customers obtain a proportional share of the additional storage capacity based on contribution to project costs. SoCalGas asserts that TURN's proposal makes no sense because

[8] SoCalGas states in its reply brief that ORA's alternative proposal is superior to the proposals of TURN and SCGC because of the possibility that shareholders will benefit from the sale of the gas allocated to SoCalGas if it is sold for more than $3.20 per Mcf.

the core market does not need the additional storage capacity, and because the proposal is unclear whether core customers should be allocated additional capacity based solely on whether shareholders are awarded any portion of the gain on sale.

SoCalGas asserts that SCGC's proposal to transfer all of the reclassified gas to the core shares the same defects as TURN's proposal. In addition, SCGC's proposal to review gas prices after they are reported, would add an additional phase to this proceeding and should not be adopted unless SCGC can show it is worthwhile to do so. SoCalGas also contends that the subsequent review of California border prices will not provide an accurate proxy for price bidders because the value to the bidder depends on when the gas is being offered and the intended use of the gas.

B. ORA

ORA made two proposals. The first proposal is that SoCalGas be directed to sell 70% of the reclassified cushion gas (9.8 Bcf) at book cost to core customers, and that the remaining balance of 4.2 Bcf be sold on the open market using a competitive sealed bid procedure. The net proceeds from the sale would then be allocated between SoCalGas' shareholders and noncore customers.

ORA's second proposal is that the 14 Bcf of gas be split 60 / 40 between ratepayers and shareholders before any of it is sold. Of the 60% share allocated to ratepayers, ORA proposes that it be shared between the core and noncore customers on a 70 / 30 split. This would leave the core with 42% or 5.88 Bcf of the gas. The core's share would be transferred to core customers at the book cost of the gas.[9] The 8.12 Bcf of gas allocated to the shareholders (5.6 Bcf) and noncore customers (2.52 Bcf), would be sold on the open market pursuant to a competitive bidding procedure. ORA estimates, based on a $3.80 per Mcf sales price, that the sale would result in about $30,856,000 before the cost of the gas, project costs and carrying costs, and taxes are deducted.

ORA points out that SoCalGas will also receive the long term benefit of the additional storage capacity with no capital risk, and that noncore customers will obtain the long term benefit of having access to the increased storage capacity and lower storage fees. If the CSA is implemented, SoCalGas will receive 100 percent of the revenues generated from this additional storage capacity at uncapped rates beginning April 1, 2003 through August 31, 2006.

Due to gas price fluctuations, ORA states that its first proposal is less likely to be adopted by the Commission. ORA contends that its second proposal offers the most equitable and workable solution, and provides benefits to, and balances the interests of, all the concerned parties. In addition, ORA contends that its proposal provides SoCalGas with the "significant reward" that it needs to explore and propose such projects in the future.

In deciding how to allocate the anticipated gain on sale, ORA states the Commission should keep two points in mind. First, that as a result of the sale, core ratepayers will only experience the one-time benefit of buying the gas at a reduced rate. In addition to receiving the net profit from the sale of gas that is not transferred to the core, shareholders and noncore customers will experience the long-term benefits of a continuous increased revenue stream as a result of the

[9] ORA asserts that core customers would realize the difference between the book cost and the ultimate market value of about $22 million.

increase in storage capacity and injection capacity, as well as a reduction in future operating costs. The second point is that the project was primarily meant to benefit SoCalGas' shareholders and noncore customers.

ORA also points out that SoCalGas faced very little risk in undertaking this project because D.01-06-086 provided assurance that SoCalGas would recover its project costs and the book value of the gas. Since it faced very little risk, ORA contends that SoCalGas' assertion that it will be reluctant to undertake these kinds of projects in the future unless it is appropriately rewarded in this proceeding, is absurd.

ORA contends that its recommended allocation of benefits is fair and equitable in light of past Commission decisions. Past Commission decisions evaluated the treatment of the gain on sale based on the facts of each case.

ORA opposes SoCalGas' contention that the core contribute to the project costs in proportion to its share of the cushion gas. ORA opposes this because the project was meant to benefit shareholders and noncore customers by expanding the storage inventory capacity to serve noncore customers. Since shareholders and noncore customers are the real beneficiaries of the project, ORA asserts that SoCalGas and noncore customers should bear the risk of the project.

C. SCGC

Before the evidentiary hearing began, SCGC supported the proposal of SoCalGas to sell the reclassified cushion gas on the open market to the highest bidder. At the hearing, SoCalGas proposed to expense the project costs of $23 million so as to reduce taxes and increase the taxable gain. Under SoCalGas' proposal, approximately 20% of the shareable gain would be lost to taxation.

At the hearing, TURN suggested transferring the gas to SoCalGas' Gas Acquisition Department to avoid the tax liability. SCGC supports TURN's proposal to increase the amount of shareable gain, and avoid the tax consequences that would result from a sale of the 14 Bcf of gas. However, SCGC opposes TURN's proposal to prevent noncore customers from sharing in any portion of the gain realized from the reclassified gas.[10] Since noncore customers have borne 30% of the carrying cost of the cushion gas, SCGC contends that the noncore should receive 30% of the gain.

SCGC contends that the primary problem with this tax avoidance strategy is developing a value for the gas. SCGC recommends that the Commission value the reclassified gas at a later time based on actual daily winter border gas prices experienced during the upcoming winter. SCGC suggests that the Commission transfer the cushion gas to the Gas Acquisition Department by November 1, 2002, for its use during the upcoming winter season, November 1, 2002 through March 31, 2003. In April 2003, SCGC suggests that a workshop be convened to review reported daily California border prices for the four winter months, and solicit proposals from the parties for establishing a weighted average of the daily border price that would be used for establishing the value of the 14 Bcf for the winter period. This would result in the gross value of the cushion gas. The $4.6 million in book value of the gas, and the project cost of $23 million, should then be subtracted to determine the shareable gain.

SCGC proposes that the balance of the shareable gain go to ratepayers and that it be divided between core and noncore customers on a 70/30 basis.

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[10] SCGC contends that TURN's argument that noncore customers should not get anything because the core would bear the burden of price volatility ignores SCGC's proposal to use a weighted average of daily border prices. SCGC asserts that this weighted average approach would result in the core and noncore sharing the benefits and burdens of price fluctuation.

According to SCGC, this 70/30 split reflects the ratio by which core and noncore customers have borne the carrying costs of the cushion gas, and this split follows the precedent established in the Montebello case in D.01-06-081.

With regard to the additional storage capacity, SCGC states that shareholders should receive their allowed share of the proceeds.[11] Under the current gas structure, SoCalGas is required to share 50% of its storage revenues from the unbundled storage program with ratepayers. If the CSA is implemented as proposed by SoCalGas, SoCalGas would retain 100% of the unbundled storage revenues effective April 1, 2003.

SCGC asserts that SoCalGas' proposal that it receive 50% of the gain, net of project costs, should not be adopted. SCGC contends that SoCalGas' use of the Montebello decision to support the 50% split is not compelling because in Montebello, the cushion gas was being sold from a field which was being abandoned. The two storage fields at issue in this proceeding still have valuable inventory and injection capacity available for sale. In addition, SCGC points out that SoCalGas' shareholders will benefit from the immediate recovery of $23 million of the project costs, and the opportunity to derive substantial

[11] SCGC contends that the additional storage capacity available for sale through SoCalGas' unbundled storage gas program will increase by 11 to 14 Bcf. If this storage capacity is sold at current tariff levels of 21.4 cents per dth, the revenues from the sale of this additional capacity would amount to $2.4 to $3.0 million per year, or approximately $30 million over the next 10 years. However, SCGC believes that this is a low estimate of likely annual revenue since SoCalGas can sell unbundled storage capacity for a much higher price under the Schedule G-TBS program. SCGC also asserts that SoCalGas can profit from the increased injection capacity that will be available at both Aliso Canyon and La Goleta.

incremental annual revenues from the sale of the additional storage capacity. Thus, SoCalGas' shareholders should not be entitled to share in any net gain.

SCGC opposes the two proposals of ORA because an unfair amount of the reclassified gas would be allocated to the core to the detriment of noncore customers. SCGC also asserts that the ORA proposals do not comply with D.01-06-086 because the proposals would not allow SoCalGas to recover its project costs. If ORA's first proposal to sell 4.2 Bcf of the reclassified gas on the open market is adopted, and assuming it is sold at $3.80 per Mcf, only $16 million in pre-tax revenue would be generated. SCGC points out that this $16 million is not enough to cover SoCalGas' project costs, or to leave anything for noncore customers. Under ORA's second proposal, and assuming a $3.80 per Mcf gas price, noncore customers would receive less than $1 million, while core customers would derive a benefit of approximately $22 million.

If a sale of the gas takes place on the open market, SCGC recommends that the purchasers of the gas be permitted to withdraw the gas over a 12-month period instead of being required to withdraw the gas during the five months of November 2002 through March 2003, as proposed by SoCalGas. SCGC contends that restricting the withdrawal period would reduce the market value of the gas, especially for electric generators who may have a greater use for the gas during the summer months. In addition, SCGC asserts that restricting the withdrawal period for five months would force the purchasers of the gas to purchase firm withdrawal in order to use the gas to meet winter balancing requirements. By restricting the withdrawal period to five months, SCGC asserts that SoCalGas is merely enhancing SoCalGas' incremental revenues from the sale of firm withdrawal service during the winter.

SCGC also recommends that SoCalGas be directed to allow customers that already have storage capacity to transfer some or all of the reclassified gas into their storage capacity accounts, instead of being required to withdraw the gas during a specified withdrawal period, provided the customer has sufficient inventory and injection capacity during the time the transfer is requested. SCGC contends this added flexibility would enhance the market value of the gas.

SCGC also recommends that if SoCalGas is permitted to implement unbundled storage service under the CSA, that the Commission direct SoCalGas to adjust its tariff and ceiling rates for storage products in its next performance based ratemaking (PBR) proceeding or general rate case to reflect the reduced level of rate base and operating costs associated with the reclassified gas. SoCalGas should not be permitted to argue that ratepayers will benefit from reduced operating costs and a reduced rate base, while also arguing that rates should not be reduced to reflect lower operating costs and a reduced rate base.

D. Duke Energy

In the absence of a shortage of natural gas, Duke Energy North America and Duke Energy Trading and Marketing (collectively referred to as Duke Energy) believe that the best use of the reclassified cushion gas is to sell it to the highest bidder in order to maximize the revenues from the sale of the gas. Duke Energy asserts that selling the gas on the open market will provide the Commission with the flexibility to exercise its judgement on how the revenues from the sale of the reclassified gas should be allocated.

Duke Energy contends that the sale of the gas into the open market will help ensure that the gas supply remains adequate, and it will put downward pressure on gas prices when prices tend to be at their highest. Duke Energy also states that selling the gas to the highest bidder should result in the gas being put to its most valuable use.

Duke Energy agrees with SCGC's recommendation that the reclassified gas be made available for withdrawal over a 12-month period, rather than from November through March. Duke Energy believes that the extended withdrawal period will increase the value of the gas for summer-peaking customers, and attract higher purchase prices.

Duke Energy contends that if ORA's recommendation to sell 9.8 Bcf of the reclassified gas to the core at book cost is adopted, this would reduce the benefits to both core and noncore customers by reducing the net proceeds from the sale of the reclassified gas. Duke Energy asserts that there is no need to sell 9.8 Bcf of the gas to the core because there is no physical shortage of natural gas in California, and no one is forecasting shortages for the upcoming winter due in part to high storage levels by both core and noncore customers. In addition, if the 9.8 Bcf of gas is transferred to the core, the core may have to incur either (1) unexpected storage charges on the gas now in storage while the cushion gas is withdrawn and consumed; or (2) additional storage charges on the reclassified gas, which will not be needed to meet core demand. If the core portfolio needs to purchase additional gas in the market this winter, Duke Energy believes that it would be more efficient and beneficial for the core to use some of the allocated proceeds from the sale of the reclassified gas for a focused purchase of the precise quantities needed, rather than being forced to purchase the large quantities that ORA recommends.

Duke Energy also believes that SoCalGas should be authorized to recover the prudent costs of the work that was performed to free up the 14 Bcf of cushion gas and reasonable carrying costs.

Duke Energy contends that the net revenues from the sale of the reclassified gas should be allocated 70% to the core and 30% to the noncore. Duke Energy believes the 70/30 split represents the general allocation of storage costs between core and noncore customers over the last few years.

E. TURN

TURN notes that the approach that is used to dispose of the gas will affect the total amount of gain available for sharing. TURN states that transferring the reclassified gas to core customers will avoid the tax liability. Assuming a gas price of $3.80, TURN notes that the transfer of all the gas to the core would result in net proceeds of $25.6 million after paying for the gas and project costs. Thus, TURN recommends that the Commission order SoCalGas to transfer all 14 Bcf of the reclassified gas to the core Gas Acquisition Department at a price that compensates the utility for the book value of the gas ($4.6 million) plus all project costs ($23 million).[12]

TURN does not oppose SoCalGas' proposal to classify the additional storage capacity as part of the unbundled storage program provided SoCalGas does not seek additional shareholder profits from the sale of the reclassified gas.[13] By classifying the additional capacity in this manner, SoCalGas will be

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[12] TURN originally supported ORA's proposal to transfer 9.8 Bcf of the gas to core customers. However, as gas prices dropped, project costs increased, and the realization that capital gains would consume a large part of the expected profits, TURN recognized that avoiding the payment of income taxes from a market sale would significantly impact project benefits.

[13] TURN points out that SoCalGas has also earned a rate of return on Aliso Canyon and La Goleta for a number of years. (See D.01-06-086, p. 23.)

able to sell this increased unbundled storage capacity, and it will be able to keep 50% of any excess revenues for its shareholders. However, if the Commission grants SoCalGas any profits from the sale of the gas, then TURN recommends that either (1) SoCalGas be placed at risk of cost recovery; or (2) core customers be given a proportional share, based on contribution to project costs, of the additional capacity, which should be allocated to core storage.

Although noncore customers would receive no portion of the gain from the sale of the gas under TURN's proposal, noncore customers would not bear any of the risks of the project costs since core customers would pay for the entire project costs. In addition, noncore customers benefit in three ways from the expanded unbundled capacity. First, since any excess revenues from the sale of the additional storage capacity are to be split 50/50 between shareholders and ratepayers, the ratepayer portion would be allocated on an equal cents-per-therm basis.[14] This would result in noncore customers receiving about 65% of the ratepayer portion. Second, noncore customers would benefit from gas commodity price reductions at the border due to the increase in unbundled storage capacity. And third, noncore customers will reap the benefits of a lower unit storage price after the storage revenue requirement is determined in the next cost of service or PBR proceeding.

In order to accomplish this transfer, TURN states that all of the gas should be booked to the core Purchased Gas Account at a cost of $27.6 million. The benefits to the core will accrue as the 14 Bcf of gas is withdrawn from storage. The Commission should also order SoCalGas to account for this gas as if it had

[14] TURN estimates that based on the equal cents-per-therm allocation, core customers will receive approximately 13% of the excess storage revenues.

been purchased on October 31 following the Commission decision. Such treatment will ensure that under the "Last In-First Out" gas accounting rules, the core weighted average cost of gas will include the reclassified gas as the first gas withdrawn from storage during the winter season.

TURN contends that the long term benefit of this project was to increase the available storage capacity by 11 to 14 Bcf. TURN asserts that this benefit needs to be considered when determining how to equitably allocate the gain on sale. If this additional storage capacity is allocated to the unbundled storage program, TURN contends that noncore customers will benefit from this additional storage because the core does not purchase unbundled capacity. In addition, this additional storage capacity will benefit SoCalGas' shareholders because SoCalGas can charge negotiated rates for unbundled storage inventory capacity. Since this inventory capacity is usually sold with injection and withdrawal services, [15] TURN estimates that this expanded storage capacity is likely to earn incremental revenues of $8.9 to $11.4 million per year.[16]

TURN contends that any incremental revenue from the additional storage capacity is likely to contribute to "excess" revenues above the revenue

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[15] TURN points out that SoCalGas witness Mansdorfer testified that injection rates at the two storage fields would increase by 7% and 8%. TURN maintains that this additional injection capacity will allow for more revenues from the sale of the storage services.

[16] TURN's estimate of the revenue from the incremental storage capacity is based on a proxy of $0.81 per decatherm, rather than the $0.21 per decatherm tariff rate that SoCalGas uses. Based on actual revenues for 2001 and 2002, and the fact that SoCalGas has sold out its inventory of capacity for 2003, TURN asserts that the per decatherm value of the incremental storage inventory capacity is probably closer to TURN's proxy estimate.

requirement. This excess revenue is currently split 50/50 between ratepayers and shareholders. If the CSA is adopted, TURN contends that SoCalGas has taken the position that it should be allowed to keep 100% of the profits above the revenue requirement after March 31, 2003. Assuming that incremental revenues from the expanded inventory capacity are $11.4 million per year and 50/50 sharing continues, TURN states that SoCalGas shareholders will receive about $5.7 million annually in profits from the project expansion.

TURN contends that SoCalGas' proposal that shareholders receive 50% of any gain on sale of the gas commodity, as well as immediate recovery of their investment, is overreaching and an attempt to extract additional profits from performing work that is integral to its fundamental job of providing gas service. TURN asserts that the decisions cited by SoCalGas in support of its proposals are inapplicable. Instead, the Commission has considered that "the proportionate amount of time the property had been rate based and non-rate based" is a proper measure of the relative risk to ratepayers and shareholders. (D.94-09-032 [56 CPUC2d at 12].)

TURN also asserts that the Commission's policy on gain on sale tend to be case-specific, and that there are significant equity arguments for denying shareholders any gain from the gas sale proceeds. Even though SoCalGas made the up-front capital investment, the Commission authorized full recovery of the costs from the sale proceeds. In addition, SoCalGas will acquire substantial profits from the sale of the additional unbundled capacity resulting from the drilling work that will provide benefits to noncore customers.[17]

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[17] TURN points out that the Montebello decision is distinguishable because SoCalGas abandoned the storage field in that proceeding. Here, instead of abandoning the two

Footnote continued on next page

TURN contends that SoCalGas' explanations for the cost overruns are not reasonable. SoCalGas originally estimated a project cost of about $16 million. The final cost of the project is $21.5 million, or 34% over budget. SoCalGas' witness testified that the primary causes of the cost overruns were higher than estimated drilling contractor unit costs. TURN asserts that SoCalGas had sufficient information in Spring 2001 to take into account these increased drilling costs but did not do so. However, TURN does not recommend any disallowance of the project costs.

IV. Discussion

In order to decide what should be done with the 14 Bcf of reclassified gas, how the proceeds should be allocated, and how the additional storage capacity should be classified, a review of the different parties' proposals and their impacts need to be discussed.

The parties have proposed five different methods for the sale or transfer of the reclassified gas, and the allocation of the proceeds. The first proposal, which SoCalGas advocates, and which is supported by Duke Energy, is to allow SoCalGas to sell the entire 14 Bcf using a sealed bid process. The net gain from such a sale would be allocated 50% to ratepayers, and 50% to SoCalGas' shareholders.

The second proposal is ORA's proposal to have 70% of the reclassified gas (9.8 Bcf) transferred to the core at book cost, and the remaining balance of 4.2 Bcf sold on the open market using a sealed bid process.

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storage fields, SoCalGas expanded the storage capacity to be sold to noncore customers. Since none of the benefits flow to core customers, TURN contends it is only equitable that core customers keep the entire gain on the sale of the cushion gas.

The third proposal is the alternative proposal of ORA, which proposes that the 14 Bcf of gas be split 60 / 40 between ratepayers and shareholders prior to any sale. Of the 60% allocated to ratepayers, ORA proposes that the core be allocated 70% at book cost, and that noncore customers be allocated 30%. The gas allocated to the shareholders and noncore customers, 8.12 Bcf, would be sold on the open market pursuant to a sealed bid process.

The fourth proposal is TURN's proposal to transfer all of the reclassified gas to the core Gas Acquisition Department at a price which compensates SoCalGas for the book value of the gas plus all project costs.

The fifth proposal is SCGC's proposal to transfer all of the reclassified gas to the Gas Acquisition Department by November 1, 2002 for its use during the winter season of November 1, 2002 through March 31, 2003. SCGC's proposal calls for a subsequent review of California gas border prices during the winter in a workshop to be held in April 2003, followed by the parties' proposals to establish a weighted average of the daily border price to be used for establishing the value of the 14 Bcf for the winter period. This would then result in a gross value for the 14 Bcf of gas. From this amount, SoCalGas would receive the book value of the gas and the project costs. The remaining balance would then be shared between core and noncore customers on a 70 / 30 basis.

The five proposals acknowledge that the additional storage capacity created by the project should be assigned to the noncore unbundled storage program.

Each proposal will impact core and noncore customers and shareholders in different ways. If we assume that the reclassified gas is sold at $3.80 per Mcf, under the proposal of SoCalGas, the market value of the gas would be $53.2 million. Subtracting out the book value of the gas of $4.6 million and the project costs with AFUDC of $23 million would leave $25.6 million. Assuming taxes are 40.75% ($10.4 million), this would leave a net gain of $15.2 million. Under SoCalGas' proposal to allocate the gain on sale on a 50/50 basis between ratepayers and shareholders, SoCalGas' shareholders would receive $7.6 million. SoCalGas proposes that core and noncore ratepayers share the $7.6 million on an equal percent of marginal cost basis.

Under ORA's first proposal, 9.8 Bcf of the reclassified gas would be transferred to the core at book cost. The transfer to the core at book value will reduce the overall price of core gas during the winter, and reduce the need to buy additional gas supplies at the border. Assuming a sales price of $3.80 per Mcf, the sale of the remaining 4.2 Bcf would result in $15.96 million. Under ORA's proposal, the proceeds would be used to pay SoCalGas for the remaining book value of the gas and the cost of the project. However, since the project costs with AFUDC are $23 million, the sale of the 4.2 Bcf of gas would not be enough to reimburse SoCalGas for these costs.

Under ORA's 60/40 alternative proposal, the core would be allocated 5.88 Bcf of the reclassified gas at book cost. Assuming a sales price of $3.80 per Mcf, the noncore's allocation of 2.52 Bcf and the shareholders' allocation of 5.6 Bcf would result in a total sales price of $30.86 million before project costs are subtracted. The remaining gain after taxes would be about $3.12 million, which would be split between shareholders and noncore customers with 69% going to shareholders and 31% going to noncore customers.

Under TURN's proposal, the 14 Bcf of reclassified gas would be transferred to core customers at a price that allows SoCalGas to recover the book value of the gas and project costs, i.e., $27.6 million.[18] Assuming a gas price of $3.80 per Mcf, core customers would realize a benefit from a $25.6 million reduction in gas costs once the 14 Bcf of gas is withdrawn.

The impact on customers and shareholders under SCGC's proposal depends on the ex post valuation methodology that is adopted. Assuming a weighted average cost of gas of $3.80 per Mcf, there would be about $25.6 million to share with core and noncore customers after the book cost of the gas and the project costs are deducted.

Another important aspect to this project, and one that must be considered by the Commission, is the additional storage capacity. As a result of the well drilling and reconfiguration work, and the reclassification of the 14 Bcf of cushion gas into working gas, an additional 11 to 14 Bcf of storage capacity will be made available.

SoCalGas estimates that this incremental storage capacity, based on current tariff levels of 21.4 cents per dth, will generate $2.4 to $3.0 million per year. SCGC and TURN contend that SoCalGas' estimates of these annual revenues are too low. As acknowledged by SoCalGas' witness, SoCalGas can sell unbundled storage capacity at a very high price under the Schedule G-TBS program. In addition, SCGC and TURN assert that there will be incremental profits from additional injection and withdrawal capacity associated with the

[18] TURN proposes that the transfer be accomplished by booking the 14 Bcf of reclassified gas to the core Purchased Gas Account at a cost of $27.6 million. TURN recommends that the Commission order SoCalGas to account for this gas as if it had been purchased on the October 31 following the Commission decision so that under the last in-first out accounting rules, the core weighted average cost of gas includes the reclassified gas as the first gas withdrawn from storage during the winter season.

additional storage capacity. TURN estimates that the additional revenue from the expanded storage capacity and related injection and withdrawal services will range from $8.9 to $11.4 million per year.

The incremental revenues from the additional storage capacity would be treated as excess revenues. Under the existing gas structure, excess revenues are split 50/50 between shareholders and ratepayers. Thus, assuming incremental revenues of $8.9 to $11.4 million per year and the continuation of 50/50 sharing, ratepayers and SoCalGas' shareholders each could receive about $4.45 to $5.7 million on an annual basis. If the CSA is implemented in the manner desired by SoCalGas, it would be allowed to keep 100% of the profits above the revenue requirement after March 31, 2003.

Another factor to consider are the benefits of the project. In D.01-06-086, we found that the project would have "monetary and operational benefits that will benefit the public if the Commission authorizes SoCalGas to proceed." (D.01-06-086, pp. 25, 34.) These benefits included the estimated revenue from the sale of the reclassified gas at what were then, high border gas prices; the 14 Bcf of gas that would be made available; the temporary increase in additional capacity on SoCalGas' system; the additional storage capacity; and the lower operating costs for the storage facilities.

Although border gas prices have dropped significantly, depending on which proposal is adopted, there may still be a net gain resulting from the sale of the gas that could benefit both ratepayers and shareholders. The availability of the 14 Bcf of gas was timed to "make more gas available during a time of high gas border prices, and the winter demand for more gas supplies," and to help alleviate the demand for natural gas to feed electrical generation units. (D.01-06-086, p. 25.) During the timeframe in which this project was authorized, the additional supply benefited noncore customers by making more gas available and reducing the need for winter curtailments. The additional supply also indirectly benefited core customers because electric generation customers could use the additional supply to generate electricity.

As for the additional storage capacity, noncore customers will benefit from the storage, and both shareholders and ratepayers will benefit from the excess revenues generated by the sale of the additional storage capacity during the 50/50 sharing. If the CSA is implemented as proposed by SoCalGas, the excess revenues from the additional capacity will benefit SoCalGas exclusively. The lower operating costs of the storage facilities benefit both core and noncore customers. Shareholders have also benefited over the years from receiving a rate of return on the 14 Bcf of cushion gas.

SoCalGas argues that it should be rewarded for taking the initiative for developing a project that benefited ratepayers. Although SoCalGas used its own monies to fund the project work, it did not begin the project until the Commission authorized it to do so in D.01-06-086. That decision also authorized SoCalGas to recover the estimated $16 million in project costs, and the book cost of the reclassified gas, from the sale proceeds of the reclassified gas. Thus, when SoCalGas undertook the project, it had assurances from the Commission that SoCalGas could recover its estimated project costs and the book cost of the gas. Any suggestion that SoCalGas should be rewarded because it undertook the project at its own risk simply is untrue.

In deciding which proposal to adopt, TURN and SCGC point out that the tax consequences of each proposal should be considered. The disadvantage of selling all or some of the reclassified gas on the open market is that it would result in the taxation of a portion of the gas sale proceeds, which in turn reduces the net gain that can be shared. The transfer concept would eliminate the need for paying taxes. However, under the proposed transfer proposals of TURN and SCGC, no monetary benefits beyond the recovery of the book cost of the gas and the project costs would be conferred on shareholders.

In order to decide what should be done with the reclassified gas, and how this will impact ratepayers and shareholders, the Commission needs to weigh all of the above considerations. This weighing process is consistent with past Commission decisions in determining how to treat the disposition of utility property. As noted in D.01-06-081 at page 16, the decision in which we addressed the disposition of the assets at SoCalGas' Montebello gas storage field, we stated:

> "The treatment of gain on sale of utility property has been essentially a case by case assessment and ratepayer/shareholder sharing ratios vary widely. Thus, past Commission decisions offer an array of illustrative examples but no precedent, whether the focus is depreciable property or nondepreciable property, such as the cushion gas which would yield most of the gain in this proceeding."

All five of the proposals offer different outcomes. However, in four out of the five proposals, and assuming that gas prices remain around $3.80 per Mcf, SoCalGas is likely to receive all of its project costs and the book value of the reclassified gas. In addition, the revenues from the additional storage inventory capacity will be shared initially on a 50/50 basis with ratepayers and shareholders, and if the CSA is implemented as proposed by SoCalGas, 100% of the excess revenues will go to SoCalGas.

Thus, the central focus of all the parties is whether some or all of the reclassified gas should be sold on the open market, and whether ratepayers and shareholders should share in any remaining net gain. To resolve this issue, three overriding considerations weigh on our minds. The first consideration is the tax impact from a sale of the reclassified gas. The second consideration are the future benefits that ratepayers and shareholders will receive from the additional storage capacity, as mentioned earlier. The third consideration is whether the core needs any of the reclassified gas.

If we adopt SoCalGas' proposal to sell all of the reclassified gas on the open market, the tax liability is estimated at $10.4 million. Of the remaining net gain, shareholders would receive approximately $7.6 million, and ratepayers would share approximately $7.6 million. Under ORA's alternative proposal, the tax liability would be about $2.11 million, and of the remaining net gain, shareholders would receive about $2.12 million, and noncore customers would receive about $951,000. Under the proposals of TURN and SCGC, there would be no tax liability because the 14 Bcf of gas would be transferred to the core Gas Acquisition Department. However, under the proposal of TURN, shareholders and noncore customers do not receive any monetary benefit from the transfer of the reclassified gas to the core. And under the proposal of SCGC, shareholders do not receive any monetary benefit.

Regarding the core's need for the reclassified gas, there has been testimony that the core is likely to meet its storage target for the upcoming winter, that the book cost of the reclassified gas would lower the core's cost of gas, and that the additional storage capacity is not needed by the core.

Weighing all of the above considerations, ORA's alternative 60/40 proposal should be adopted. This proposal, although it does not eliminate the tax liability, minimizes the tax impact. By allocating 5.88 Bcf of the gas to the core at book cost at $0.33 per Mcf, this will help lower the core's cost of gas. At the same time, ORA's proposal should be sufficient to allow SoCalGas to recover the remaining book cost of the reclassified gas and all $23 million of the project costs from the sale of the 8.12 Bcf of reclassified gas. The sale of the gas also provides SoCalGas' shareholders and noncore customers with an opportunity to share any remaining net gain.

We will also adopt SoCalGas' proposal, which no one opposes, to classify the 11 to 14 Bcf of additional storage capacity created by this project as part of the noncore unbundled storage program. As it currently stands, excess revenues from this program are split on a 50/50 basis with ratepayers and shareholders. We recognize that if the CSA is implemented as proposed by SoCalGas, that its shareholders will receive 100% of the excess revenues. Today's decision, however, does not address the outstanding issues surrounding the implementation of the CSA, and should not be construed as such.

The estimates vary widely of how much SoCalGas' shareholders and ratepayers stand to gain from the revenues generated by the additional storage capacity and the associated injection and withdrawal services. Based on the testimony, we believe that SoCalGas underestimates the value of the additional storage capacity and the associated injection and withdrawal services. It is reasonable to expect that the additional capacity and related services will generate at least $3 million per year. Regardless of how the excess revenues are split with SoCalGas' shareholders, the additional storage capacity created by the project, provides substantial monetary benefits to SoCalGas' shareholders which cannot be ignored. These long term benefits are an integral part of our decision to adopt ORA's 60/40 proposal.

There are several remaining issues to address. In the June 7, 2002 ruling, the parties were directed to provide comments about the additional project costs over the original estimate, and the water intrusion issues. The project costs have grown from an estimate of $16 million to approximately $21.5 million.[19] SoCalGas provided testimony on the various factors which led to an increase in the project costs. Although TURN and ORA have questioned whether the increased costs were justified, neither of them recommend a disallowance. The testimony suggests that SoCalGas should have realized earlier, based on energy prices and the availability of drilling rigs, that the project costs would be higher than what was estimated in the application. However, D.01-06-086 recognized that the $16 million was an estimate and that the project would provide monetary and operational benefits. D.01-06-086 also authorized SoCalGas to recover the project costs estimated at approximately $16 million from the sale proceeds of the gas. Based on the circumstances which led to the adoption of D.01-06-086, we will permit SoCalGas to recover the $23 million in project costs from the sale proceeds of the 8.12 Bcf of reclassified gas.

The water intrusion issues relate to the ability to use the entire 14 Bcf of storage capacity that will be made available by the removal of the 14 Bcf of reclassified cushion gas. Until the 14 Bcf of gas is withdrawn, gas is reinjected, and operating conditions are known, SoCalGas estimates that initially only 11 Bcf of the additional storage capacity can be used in the first few years. No evidence was presented which suggests that the water intrusion will impair SoCalGas' ability to use less than 11 Bcf of the additional storage capacity.

SCGC recommends that if the reclassified gas is sold on the open market, purchasers should be allowed to withdraw the gas over a 12-month period instead of five months. We will not adopt SCGC's recommendation for a

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[19] The AFUDC makes up about $1.5 million of the total project cost of $23 million.

12-month withdrawal period because this could interfere with the sale of the 11 to 14 Bcf of additional storage capacity, and injection of gas into this additional storage for the winter of 2003-2004.

SCGC also proposes that if the CSA is implemented, that SoCalGas should be required to adjust its tariff and ceiling rate for the noncore unbundled storage products to reflect the reduced level of rate base and operating costs. We do not adopt SCGC's proposal because the CSA adopted in D.01-12-018 contains provisions which address storage cost savings.

SoCalGas should be authorized to carry out all necessary steps to transfer 5.88 Bcf of the reclassified gas to the core at book cost, and to allocate 2.52 Bcf to noncore customers and 5.6 Bcf to SoCalGas and to sell that 8.12 Bcf of gas on the open market using a sealed bid procedure as described in SoCalGas' application, and in its July 6, 2001 comments on whether restrictions on the sale of the reclassified gas should be imposed. In its comments to the proposed decision, SoCalGas made several recommendations for carrying out the transfer and sale of the reclassified gas in an expeditious manner. None of the reply comments took issue with the recommendations. To equalize the gas volumes in each bid increment, SoCalGas recommends that it sell the 8.12 Bcf of gas in eight blocks of increments of 1.015 Bcf. SoCalGas proposes a one-round sealed bid process, and that any qualified bidder may submit up to eight bids of 1.015 Bcf, and that a different bid price may be submitted for each bid. SoCalGas proposes to award the 8.12 Bcf to the eight highest bids received. In the event of a tie for the last block of 1.015 Bcf, SoCalGas proposes to prorate the volume of this block equally among the tying bidders.

With respect to the 5.88 Bcf of gas, SoCalGas proposes to transfer the 5.88 Bcf of reclassified cushion gas into the core working gas inventory at a book value unit cost of $0.33 per Mcf as soon as practicable following the effective date of this decision. The benefit resulting from this transfer would be included in the Core Monthly Procurement Rate (CMPR) over the remaining 2002-2003 winter heating season. The unit cost of this gas would also be priced into the CMPR withdrawal gas component as described in SoCalGas Schedule G-CP and would also be charged to the Purchase Gas Account at the same unit cost.

With regard to the 2.52 Bcf noncore share of the 8.12 Bcf of cushion gas to be sold by SoCalGas, SoCalGas proposes to disburse 31% of any net after-tax gain from the sale of this gas through a reduction in noncore gas transportation rates on an equal-cents-per-therm basis. This rate adjustment would be reflected in rates at the earliest of the first January 1 rate adjustment or other noncore transportation rate adjustment following the effective date of this decision and completion of the sale.

SoCalGas' recommendations, as specified above, for carrying out the steps to transfer 5.88 Bcf of the reclassified gas to the core at book cost, and to sell the 8.12 Bcf of gas on the open market, should be adopted. SoCalGas should also be authorized to file the advice letters necessary to make the appropriate accounting entries for these transfers, the sale of the 8.12 Bcf of reclassified gas and the allocation of the proceeds, and to reimburse SoCalGas for the book cost of the reclassified gas and the $23 million in project costs.

In its comments and reply comments to the proposed decision, SoCalGas requests that if the sale of the 8.12 Bcf of reclassified cushion gas is insufficient to enable SoCalGas to recover its project costs and the remaining book value of the gas, that any shortfall be recovered from the 5.88 Bcf transferred to core procurement customers. SoCalGas contends that its request is consistent with the assurance in D.01-06-086 that SoCalGas be allowed to recover its project costs and the book cost of the reclassified gas. We decline to adopt SoCalGas' request. However, should the sale proceeds from the 8.12 Bcf fall short of allowing SoCalGas to recover its project costs and the remaining book cost of the reclassified gas, the Commission will explore how SoCalGas can recover this potential shortfall.

V. Comments on Proposed Decision

Pursuant to Rule 77.1, the proposed decision of the administrative law judge (ALJ) was mailed to the parties on October 8, 2002. Comments on the proposed decision, as well as reply comments, were filed. All of the comments have been considered, and appropriate changes have been made to the decision.

VI. Assignment of Proceeding

Commissioner Lynch is the Assigned Commissioner, and ALJ Wong is the assigned ALJ in this proceeding.

Findings of Fact

1. D.01-06-086 authorized SoCalGas to perform the well drilling and associated work that allowed it to free up and reclassify 14 Bcf of cushion gas as working gas available for sale at its Aliso Canyon and La Goleta storage fields.

2. D.01-06-086 prohibits SoCalGas from selling the reclassified cushion gas until the Commission directs SoCalGas to do so on the terms and conditions specified in a future Commission decision.

3. The parties have proposed five different methods for the sale or transfer of the reclassified gas, and how to allocate the proceeds. The parties' proposals do not oppose SoCalGas' request to assign the additional storage capacity created by the project to the noncore unbundled storage program. Each proposal will impact core and noncore customers, and shareholders in different ways.

4. The additional storage capacity, which may range from 11 to 14 Bcf, is an important consideration that the Commission needs to take into account.

5. Under the current gas structure for SoCalGas, the excess storage capacity revenues are shared on a 50/50 basis with ratepayers and shareholders.

6. If the CSA is implemented as proposed by SoCalGas, it would retain 100% of the excess storage capacity revenues effective April 1, 2003.

7. SoCalGas estimates that the incremental storage capacity will generate $2.4 to $3.0 million per year.

8. SoCalGas acknowledges that it can sell unbundled storage capacity at a very high price under the Schedule G-TBS program.

9. TURN estimates that the additional revenue from the expanded storage capacity and related injection and withdrawal services will range from $8.9 to $11.4 million per year.

10. D.01-06-086 found that the project would have monetary and operational benefits that would benefit the public.

11. Although SoCalGas used its own monies to fund the project, it did not begin the project until the Commission authorized it to do so, and authorized the recovery of an estimated $16 million in project costs and the book cost of the reclassified gas from the sale proceeds of the reclassified gas.

12. A disadvantage of selling all or some of the reclassified gas on the open market is that it would result in the taxation of a portion of the gas sale proceeds, which reduces the net gain.

13. ORA's 60/40 proposal minimizes the tax impact, helps lower the cost of gas, allows SoCalGas to recover the book cost of the gas and project costs, and provides a sharing opportunity for shareholders and noncore customers.

14. Based on the testimony, it is reasonable to expect that the additional capacity and related services will generate at least $3 million per year.

15. The additional storage capacity created by the project provides substantial monetary benefits to SoCalGas' shareholders.

16. The long term monetary benefits to SoCalGas' shareholders is an integral part of the decision to adopt ORA's 60/40 proposal.

17. Although the project costs grew from an estimated $16 million to $23 million, based on the circumstances which led to the adoption of D.01-06-086, SoCalGas should be permitted to recover the $23 million in project costs from the sale proceeds of the 8.12 Bcf of reclassified gas.

18. No evidence has been presented which suggests that water intrusion will impair SoCalGas' ability to use less than 11 Bcf of the additional storage capacity.

19. SCGC's proposal to withdraw the gas over a 12-month period could interfere with the sale of the additional storage capacity, and injection of gas into this additional storage for the winter of 2003-2004.

20. SCGC's proposal that SoCalGas should be required to adjust its tariff and ceiling rate for the noncore unbundled storage products is addressed by the CSA adopted in D.01-12-018.

21. In its comments to the proposed decision, SoCalGas made several recommendations for carrying out the steps to transfer 5.88 Bcf of the reclassified gas to the core at book cost, and to sell the 8.12 Bcf of gas on the open market.

Conclusions of Law

1. In deciding what should be done with the reclassified gas, the Commission needs to weigh all of the various considerations.

2. This weighing process for deciding how to treat the disposition of utility property is consistent with past Commission decisions.

3. ORA's alternative 60/40 proposal should be adopted.

4. SoCalGas' proposal to classify the 11 to 14 Bcf of additional storage capacity as part of the noncore unbundled storage program should be adopted.

5. SoCalGas should be authorized to carry out all the necessary steps to transfer, allocate, and sell the 14 Bcf of gas in accordance with ORA's 60/40 proposal, and to classify the additional 11 to 14 Bcf of storage capacity as part of the noncore unbundled storage program.

6. SoCalGas should be authorized to carry out the steps that it recommended in its comments to the proposed decision, as described in the text of this decision, to transfer the 5.88 Bcf of gas to the core at book cost, and to sell the 8.12 Bcf of gas on the open market.

7. If the sale proceeds from the 8.12 Bcf fall short of allowing SoCalGas to recover its project costs and the remaining book cost of the reclassified gas, the Commission will explore how this potential shortfall can be recovered by SoCalGas.

ORDER

IT IS ORDERED that:

1. Southern California Gas Company (SoCalGas) is authorized to transfer 5.88 Bcf of the 14 Bcf of reclassified cushion gas at its Aliso Canyon and La Goleta storage facilities to SoCalGas' core portfolio at book cost.

a. SoCalGas shall transfer the 5.88 Bcf of reclassified cushion gas into the core working gas inventory at a book value unit cost of $0.33 per Mcf as soon as practicable following the effective date of this decision. The benefit from this transfer shall be included in the Core Monthly Procurement Rate (CMPR) over the remaining 2002-2003 winter heating season. The unit cost of this gas shall be priced into the CMPR withdrawal gas component as described in SoCalGas

Schedule G-CP and shall also be charged to the Purchase Gas Account at the same unit cost.

2. SoCalGas is authorized to allocate 2.52 Bcf of the reclassified gas to noncore customers, and to allocate 5.6 Bcf of the reclassified gas to SoCalGas.

a. SoCalGas is authorized to sell the gas allocated to the noncore and to SoCalGas, totaling 8.12 Bcf, on the open market using the sealed bid procedure as described in its application and July 6, 2001 comments on whether restrictions on the sale of the reclassified gas should be imposed.

b. To equalize the gas volumes in each bid increment, SoCalGas shall sell the 8.12 Bcf allocated to SoCalGas for sale in increments of 1.015 Bcf. Any qualified bidder may bid for this gas, and may submit up to eight bids and may submit a different bid price for each bid. SoCalGas shall award this 8.12 Bcf to the eight highest bids received. In the event of a tie for the last block of 1.015 Bcf, SoCalGas shall prorate the volume of this block equally among the tying bidders.

c. Should SoCalGas need to deviate from the bid procedure to adjust for the smaller amount of gas to be sold on the open market, or to adjust the date when the successful bidders take possession of the gas, it may do so by filing and serving a notice of such change(s) with the Commission.

d. SoCalGas shall track the revenues generated from the sale of the 8.12 Bcf of gas in the previously authorized memorandum account for tracking the costs associated with the well redesign work, and to make the appropriate accounting entries to carry out the Office of Ratepayer Advocates' (ORA) 60/40 proposal.

e. With regard to the 2.52 Bcf noncore share of the 8.12 Bcf of cushion gas to be sold by SoCalGas, SoCalGas shall disburse 31% of any net after-tax gain from the sale of this gas through a reduction in noncore gas transportation rates on an equal-cents-per-therm basis. This rate adjustment shall be reflected in rates at the earliest of the first January 1 rate adjustment or other noncore transportation rate adjustment following the effective date of this decision and completion of the sale.

f. If the sale proceeds from the 8.12 Bcf of reclassified cushion gas fails to generate sufficient proceeds for SoCalGas to recover its project costs and the remaining book cost of the reclassified gas, the Commission will explore how this shortfall can be recovered by SoCalGas.

3. SoCalGas is authorized to classify the 11 to 14 Bcf of additional storage capacity as part of the noncore unbundled storage program.

4. SoCalGas is authorized to file any appropriate advice letters to carry out this order, and to implement ORA's 60/40 proposal for the 14 Bcf of reclassified gas.

5. Within five days of the following events, SoCalGas shall file and serve a notice describing: (1) when the transfer of 5.88 Bcf of the reclassified cushion gas to the core portfolio has taken place; and (2) when the remaining 8.12 Bcf of the gas has been sold, and the total price received for this gas.

6. This proceeding is closed.

This order is effective today.

Dated November 7, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

APPENDIX A

LIST OF APPEARANCES

************ **APPEARANCES** ************

Catherine E. Yap
BARKOVICH & YAP, INC.
PO BOX 11031
OAKLAND CA 94611
(510) 450-1270
ceyap@earthlink.net
For: Barkovich & Yap, Inc.

Paul Angelopulo
Attorney At Law
CALIFORNIA PUBLIC UTILITIES COMMISSION
LEGAL DIVISION
505 VAN NESS AVENUE
SAN FRANCISCO CA 94102
(415) 703-4742
pfa@cpuc.ca.gov
For: ORA

Avis Clark
CALPINE CORPORATION
4160 DUBLIN BLVD.
DUBLIN CA 94568
(925) 479-6640
aclark@calpine.com
For: Calpine Corporation

Criag Chancellor
CALPINE CORPORATION
6700 KOLL CENTER PARKWAY, SUITE 200
PLEASANTON CA 94566
(925) 600-2071
criagc@calpine.com
For: Calpine Corporation

Lindsey How- Downing
Attorney At Law
DAVIS WRIGHT TREMAINE, LLP
ONE EMBARCADERO, SUITE 600
SAN FRANCISCO CA 94040
(415) 276-6500
lindseyhowdowning@dwt.com
For: Calpine Corporation

Douglas K. Kerner
Attorney At Law
ELLISON, SCHNEIDER & HARRIS
2015 H STREET
SACRAMENTO CA 95814
(916) 447-2166

Brian Cragg
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111
(415) 392-7900
bcragg@gmssr.com
For: Duke Energy North America & Duke Energy Trading and Marketing

Norman A. Pedersen
Attorney At Law
HANNA AND MORTON LLP
444 SOUTH FLOWER ST., SUITE 1500
LOS ANGELES CA 90071
(213) 430-2510
npedersen@hanmor.com

Christopher A. Hilen
Attorney At Law
LEBOEUF LAMB GREENE & MACRAE LLP
ONE EMBARCADERO CENTER, STE 400
SAN FRANCISCO CA 94111
(415) 951-1141
chilen@llgm.com
For: Wouthwest Gas Corporation

John W. Leslie
Attorney At Law
LUCE FORWARD HAMILTON & SCRIPPS, LLP
600 WEST BROADWAY, SUITE 2600
SAN DIEGO CA 92101-3391
(619) 699-2536
jleslie@luce.com
For: Shell Energy

Brian K. Cherry
PACIFIC GAS & ELECTRIC COMPANY
77 BEALE STREET, B10C / 1093
SAN FRANCISCO CA 94177
(415) 973-4977
bkc7@pge.com
For: PG&E Company

Frank R. Lindh
Attorney At Law
PACIFIC GAS AND ELECTRIC COMPANY
PO BOX 7442, MS-B30A
77 BEALE STREET
SAN FRANCISCO CA 94120-7442
(415) 973-2776

dkk@eslawfirm.com
For: Independent Energy Producers Association

frl3@pge.com
For: PG&E Company

Glen Sullivan
RONALD VAN DER LEEDEN
Attorney At Law
SEMPRA ENERGY
101 ASH STREET
SAN DIEGO CA 92101-3017
(619) 699-5027
gsullivan@sempra.com
For: Southern California Gas Company

David J. Gilmore
Attorney At Law
SOUTHERN CALIFORNIA GAS COMPANY
555 WEST FIFTH STREET
LOS ANGELES CA 90071-2071
(213) 244-2945
dgilmore@sempra.com
For: Southern California Gas Company

Mark Aguirre
SOUTHERN CALIFORNIA GAS COMPANY
555 WEST FIFTH STREET
LOS ANGELES CA 90071-2071
(213) 244-5129
maguirre@semprautilities.com
For: Southern California Gas Company

Bridget Branigan
Senior Counsel
SOUTHWEST GAS CORPORATION
PO BOX 98510
5241 SPRING MOUNTAIN ROAD
LAS VEGAS NV 89193-8510
(702) 876-7396
bridget.branigan@swgas.com

Keith R. Mccrea
Attorney At Law
SUTHERLAND, ASBILL & BRENNAN LLP
1275 PENNSYLVANIA AVENUE, NW
WASHINGTON DC 20004-2415
(202) 383-0705
kmccrea@sablaw.com
For: CA Manufacturers & Tech. Assn. / CA Industrial Group

Marcel Hawiger
MIKE FLORIO
Attorney At Law
THE UTILITY REFORM NETWORK
711 VAN NESS AVENUE, SUITE 350
SAN FRANCISCO CA 94102
(415) 929-8876
marcel@turn.org